Economic Trends

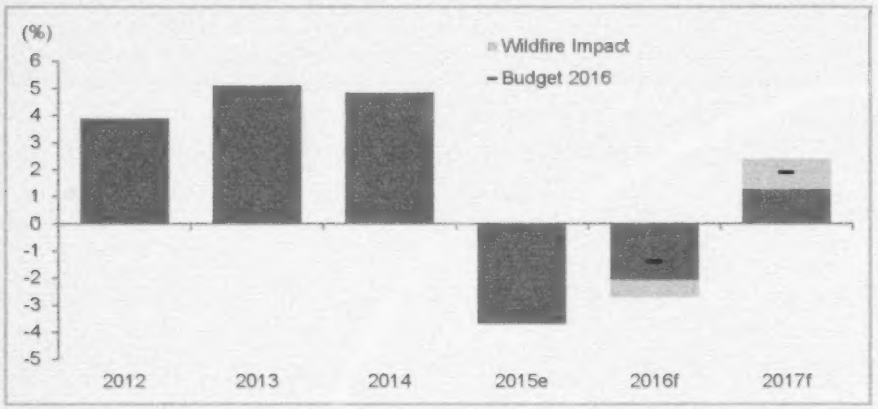
Wildfires add to economic challenges

This edition of Trends is taken from the First Quarter Fiscal Update and Economic Statement, released on August 23, 2016. This month's inFocus provides an overview of the economic impacts on Alberta from the Fort McMurray wildfires.

The steep and prolonged drop in oil prices continues to have a profound impact on Alberta's economy. This year, the impact has spread beyond the energy sector. Housing, retail activity, construction, labour markets and manufacturing are all showing significant signs of weakness. Adding to the already strong economic headwinds, forest fires in the Wood Buffalo region temporarily disrupted oil production and further reduced GDP in 2016. Alberta's real GDP is now forecast to decline by 2.7% in 2016 compared with the 1.4% reduction anticipated in *Budget 2016*. This follows an estimated contraction of 3.7% in 2015 (Chart 1).

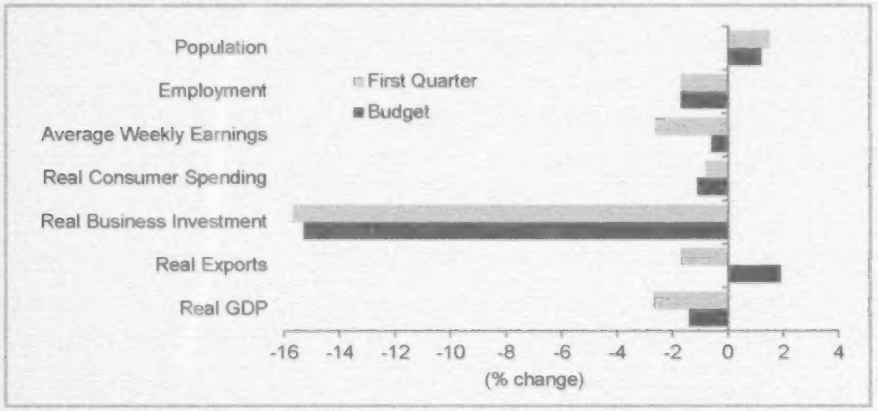
A modest recovery for the Alberta economy is forecast in 2017, supported by reconstruction in Fort McMurray and a rebound in oil production. Public sector investments in infrastructure and a small improvement in oil prices will also contribute to growth. Lower cost pressures, improved labour availability and a lower Canadian dollar will continue to cushion the effects of lower oil prices on the Alberta economy.

Chart 1: Wildfires impacting economic growth
Alberta Real GDP Growth



Sources: Statistics Canada and Alberta Treasury Board and Finance

Chart 2: Broad-based weakness in Alberta economy
Forecast of Select Economic Indicators, 2016



Source: Alberta Treasury Board and Finance

Alberta Business Sector

Oil prices remain subdued

Oil production disruptions associated with the Fort McMurray fires and instability in Libya and Nigeria have reduced supply and provided some support to oil prices so far this year. This has led to a small increase in the 2016-17 forecast price for West Texas Intermediate from US$42/bbl to $45/bbl. The impact on producers has been partly offset by a stronger Canadian dollar, which is now forecast at US¢77.0/Cdn$ for 2016-17.

Export outlook weakens

Exports, which were expected to provide a needed boost to the Alberta economy this year, are now forecast to decline. Production outages from the forest fires in the Wood Buffalo region considerably reduced real oil exports (see pages 3-4). In addition, most other categories of exports, in particular manufacturing, have weakened significantly since *Budget*.

Overall, Alberta's real exports are now forecast to fall by 1.7% compared with 1.9% growth forecast in *Budget* (Chart 2).

Investment stays low

As forecast at *Budget*, investment is expected to remain weak this year and carry into 2017. In 2016, energy investment is forecast to be about half

of 2014 levels. The construction sector will get a boost from reconstruction activity in Fort McMurray starting this year; however, overall non-energy investment is also expected to decline. Real investment is forecast to fall almost 16% in 2016 and around 2% in 2017.

Weak economic conditions, combined with oil supply disruptions, mean that net corporate operating surplus, a measure of corporate profits, is now expected to fall 27% this year compared to an anticipated 18% drop at *Budget*.

Modest recovery in 2017

Alberta's economy is expected to improve in 2017, supported by a small increase in oil prices, public sector infrastructure spending and wildfire reconstruction. A rebound in oil production will also provide a boost to growth. Real GDP is now forecast to expand by 2.4% in 2017 compared to the 1.9% that was anticipated at *Budget*. Increased investment in infrastructure is expected to add about 0.6–0.7% to real GDP in 2017.

Alberta Household Sector

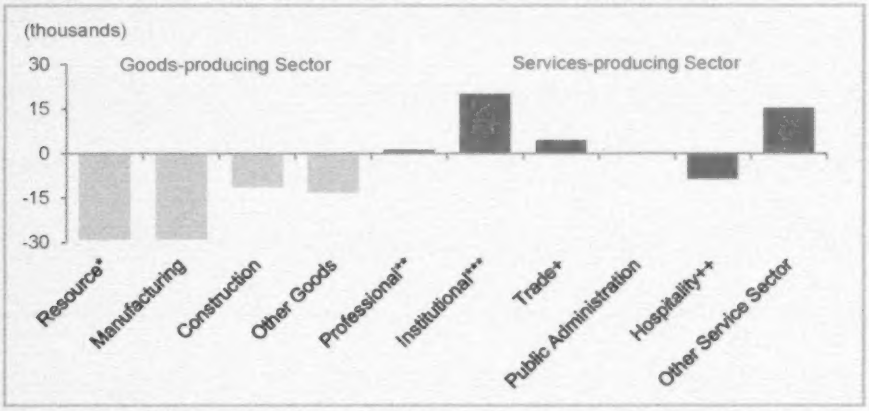
Population continues to grow

Despite the weak economy, Alberta's population is forecast to grow 1.5% in 2016, up from 1.2% in the *Budget*, bolstered by stronger than expected immigration and natural increase. Record setting immigration is forecast for this census year, boosted by Syrian refugees and the Express Entry program. This has more than offset the continued outflow of migrants to other provinces and losses in non-permanent residents.

Employment challenges persist

Employment in 2016 is expected to fall by 1.7%, in line with the *Budget* forecast. Over the last twelve months the impact of the employment reductions have been most pronounced in the goods-producing sector where employment has fallen by a total of 82,300 jobs since July 2015. These losses were partially offset by gains in the services-producing sector which grew by 33,200 jobs since July 2015 (Chart 3). A slightly larger lift in employment of 1.2% in 2017 is now forecast due to reconstruction efforts.

Chart 3: Goods sector driving job losses
Change in Alberta Employment By Sector, July 2015 to July 2016



Sources: Statistics Canada and Alberta Treasury Board and Finance
* Includes forestry, mining, oil and gas.
** Includes professional services, scientific services and technological services.
*** Includes health, social assistance and educational services.
\+ Includes transportation, trade and warehousing services.
++ Includes accommodation and food services.

After averaging 7.6% in the first six months of 2016, Alberta's unemployment rate jumped to 8.6% in July. The unemployment rate is expected to remain elevated over the last half of 2016 and average 8% for the year.

Earnings lower

Persistent labour market challenges are impacting Alberta's wages; average weekly earnings are now forecast to fall by 2.6%, two percentage points lower than *Budget*. As a result, primary household income in 2016 is forecast to fall 3.0%.

Household spending remains weak

As anticipated at *Budget*, weak labour market conditions are weighing on housing and consumer spending. Although the forecast for housing starts has been revised up slightly in 2016 and 2017, starts in 2016 are expected to be over 35% lower than in 2015. The upward revision is due in part to the reconstruction of residential homes in Fort McMurray, in addition to stronger-than-expected population growth.

The forecast decline in consumer spending anticipated in *Budget 2016* has moderated slightly to -0.8% from -1.1%, due in large part to the increased population forecast. The Alberta CPI is evolving as expected at *Budget*, with 1.4% inflation forecast in 2016.

Risks to the Outlook

- Volatility in foreign financial and commodity markets, linked in part to the Brexit vote and weak global economic conditions, could adversely impact oil prices.
- The recovery in oil prices could take longer than anticipated.
- The impact of the wildfires on Alberta's economy could be larger than anticipated.
- Increased uncertainty about the economy could impact business and consumer confidence, reducing spending and migration.

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inFocus

Impact of wildfires on Alberta economic activity

The wildfires that raged in and around Fort McMurray forced the evacuation of more than 88,000 residents at the beginning of May and covered an area the size of Prince Edward Island. Over 1,500 residential and commercial structures were destroyed and hundreds more damaged. The city was evacuated for almost a month.

The fire shuttered economic activity in the Regional Municipality of Wood Buffalo (RMWB) and reduced Alberta's oil sands production. While cleanup and reconstruction efforts will provide a positive contribution to GDP growth in the coming years, the disruption to capital projects and oil production will outweigh those effects in 2016. The estimated net impact on real GDP growth in 2016 is a reduction of 0.6 percentage points (Chart 1). A large positive impact is anticipated in 2017 (+1.0 percentage points) as reconstruction ramps up and oil production returns to normal levels, leading to a boost in export growth. The Government of Alberta net fiscal impact is currently estimated at around $500 million in 2016-17.

Immediate Aftermath

Economic activity across the RMWB was immediately and severely disrupted following the May 3 evacuation. The fire forced the closure of Highway 63, the Fort McMurray International Airport, the Northern Lights Regional Health Centre and businesses. Re-entry began June 1, but many services did not return until later in the month, including the airport reopening to commercial traffic and core health centre services. Restricted access to the most impacted neighbourhoods continues as demolition and cleanup efforts contend with dangerous toxins and debris.

Financial aid for evacuees

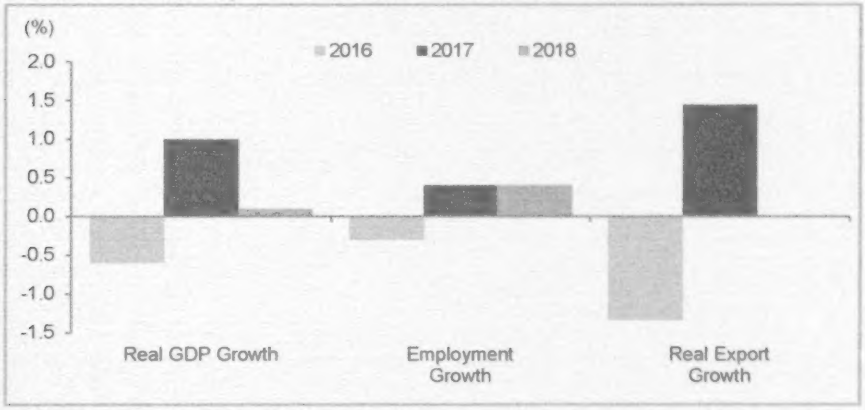
Governments, private entities and non-profit organizations responded with aid for the thousands of displaced people. This included over $275 million that was injected into the Alberta economy through Government of Alberta-issued debit cards, private donations from outside Alberta and federal and provincial commitments to match donations. Government efforts also established temporary evacuation centres and accommodations.

Economic disruption

As the threat from the wildfire climbed, it is estimated as much as 1.5 million barrels per day (bpd) of oil sands production was suspended, directly reducing the province's oil exports for the year. Based on initial estimates, it is likely at least 40 million barrels (equivalent to 110,000 bpd annually) was deferred over a two-month period. Despite oil sands production returning to more normal levels by July, this interruption is projected to reduce real oil exports by around 4% in 2016. The GDP impact will be reversed in 2017 with production levels restored to normal for a full year. Additionally, the fire halted drilling activity and delayed oil sands capital expansion plans. The capital spending is anticipated to be spent in later years as construction time lines are extended.

Forestry operations were also impacted. Extensive feed acreage was destroyed for companies harvesting in the region. Northland Forest Products, whose sawmill and log yard facility is located north of Fort McMurray, had production interrupted for a month.

Chart 1: Fort McMurray reconstruction to lift GDP growth in 2017
Estimated wildfire impact on Alberta indicators



Source: Alberta Treasury Board and Finance

What GDP measures

GDP represents the market value of all newly produced goods and services in a given time. It ignores the stock of capital and consumer goods that were previously accumulated. Damage to these stocks imposes real economic costs on people that are not reflected in GDP. A positive impact on GDP does not imply the wildfire was "good for the Alberta economy."

Alberta Government

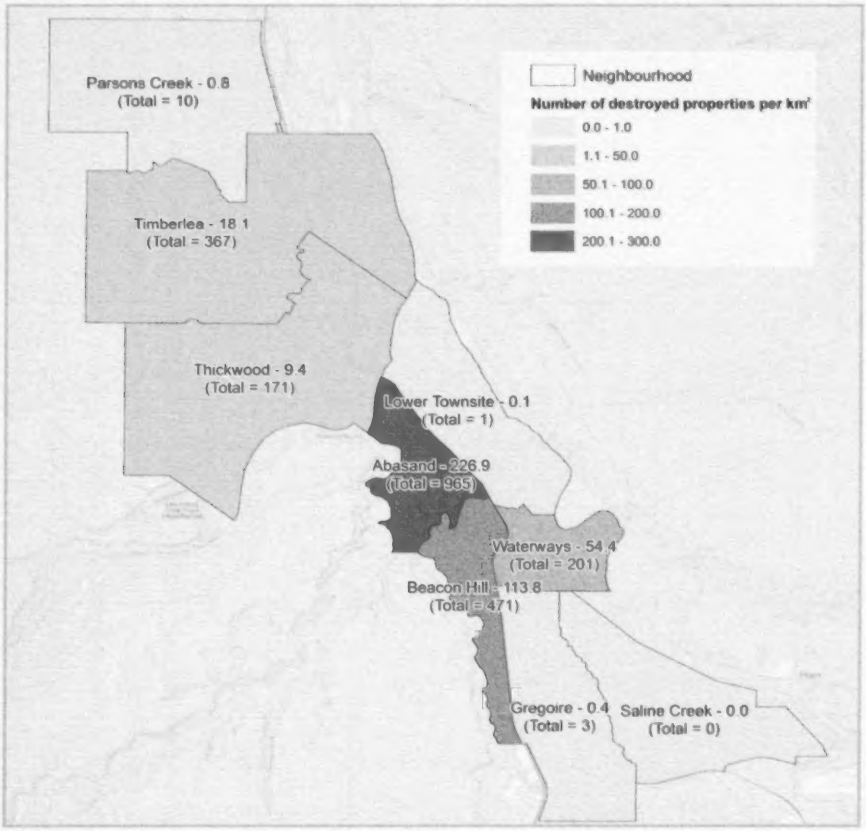
August 2016
Treasury Board and Finance
Economics and Revenue Forecasting

The scale of the evacuation and suspension of business activity negatively affected employment in the RMWB and the province. The number of Employment Insurance (EI) beneficiaries in Alberta climbed 11% in May to 77,780, the highest number on record. Wood Buffalo EI beneficiaries more than doubled to 5,270. The net impact on Alberta employment growth in 2016 from the fire is estimated to be a 0.3 percentage point reduction, as job losses from business activity disruption outweigh any gains from fighting the fire or cleanup and reconstruction. In both 2017 and 2018, reconstruction and the return to more normal business activity levels are forecast to add 0.4 percentage points to employment growth.

Reconstruction

In addition to displacing roughly 2% of Alberta's population, the fire destroyed 2,302 individual residential units, contained in 1,599 structures. All but 113 of the destroyed units were located in Fort McMurray proper (Map 1). The remaining destroyed units were primarily in Anzac, Draper and Saprae Creek, communities southeast of the city. There were 15 commercial properties destroyed. Hundreds of residential and commercial properties were damaged.

Map 1: Central neighbourhoods most heavily hit by fire
Fort McMurray residential destruction



Sources: Alberta Treasury Board and Finance, Municipal Affairs, RMWB
Note(s): 'Total' refers to total destroyed residential dwelling units in a neighbourhood

Insurance coverage

Compared with the 2013 southern Alberta floods, insurance coverage was much more comprehensive, resulting in insurable losses of $3.6 billion, according to the Insurance Bureau of Canada (IBC). That would exceed the insurable losses from both the 2013 floods and the 1998 Ontario/ Quebec ice storm. The IBC anticipates more than 27,000 residential, 12,000 automotive and 5,000 commercial claims as a result of the disaster.

Lengthy rebuilding effort

The reconstruction effort is anticipated to take years, with costs incurred by governments, insurance companies, residents and businesses.

Between 2010 and 2014, Wood Buffalo housing starts averaged 732, with a maximum of 967 in 2013. However, the fall in oil prices hit the region's housing market particularly hard, leading to a drop in construction capacity. As a result, even considering the significant slack in the labour market that the construction industry can tap into, residential reconstruction efforts will likely extend beyond 2018. Over the entire reconstruction phase, over $1 billion is expected to be spent on residential rebuilding.

In addition to the reconstruction of destroyed and damaged structures, investment in infrastructure to mitigate future risks is expected, but will also take years to complete.

Given current economic conditions, fire related cleanup and reconstruction spending is not anticipated to put significant pressure on prices and wages in the province. The rental market could tighten as over 70,000 people have already returned to Fort McMurray and accommodation is needed for displaced households until reconstruction is complete.

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